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September 9, 2004

VIA ELECTRONIC FILING

Ms. Marlene Dortch, Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: Notice of Ex Parte Presentation in CC Docket Nos. 96-98 and 99-68

Dear Ms. Dortch:

On Thursday, September 9, 2004, James Mertz of KMC Telecom, Inc., James Falvey of Xspedius Communications, LLC and Heather Gold of XO Communications, Inc., and John Heitmann and Brett Heather Freedson of Kelley Drye and Warren LLP, on behalf of KMC, Xspedius and XO, met with Matthew Brill of Commissioner Abernathy's office, to discuss issues related to the DC Circuit's remand of the FCC's *ISP Remand Order.* During the meeting, representatives of the companies discussed the importance of correcting erroneous FCC findings that ISP-bound traffic is not subject to reciprocal compensation under section 251(b)(5), as well as the importance of eliminating growth cap and new market rules that have detrimentally impacted competitive carriers and consumers. Finally, company representatives emphasized the importance of determining that ISP-bound calls using VNXX/FX arrangements also should be subject to reciprocal compensation under section 251(b)(5). The attached document was the basis for the parties' discussion.

In accordance with Rule 1.1206, this notification of oral *ex parte* presentation is submitted for inclusion in the record of the above-captioned dockets.

Please feel free to contact me at (202) 887-1211 if you have any questions or require further information.

Sincerely,

Brett Heather Freedson

Attachment

cc: Matthew Brill

September 9, 2004

KMC / XO / XSPEDIUS

EX PARTE PRESENTATION: CC DOCKET NOS. 96-98 AND 99-68

I. Reciprocal Compensation for ISP-Bound Traffic Is Required Under Section 251(b)(5) of the Act

- **Section 251(b)(5) Applies to All Telecommunications.** Section 251(b)(5) of the Act requires that a LEC "establish reciprocal compensation arrangements for transport and termination of telecommunications."
  - The duty established by section 251(b)(5) of the Act applies to *all* telecommunications, including calls delivered to an ISP.
  - In the *ISP Remand Order*, the Commission correctly acknowledged the broad scope of section 251(b)(5) of the Act: "[o]n its face, carriers are required to establish reciprocal compensation arrangements for transport and termination of *all* telecommunications they exchange with another telecommunications carrier, without exception."

- **The Only Exception – Section 251(g) – Does Not Apply to ISP-Bound Traffic.** Under the Act, the *only* traffic exempt from the reciprocal compensation obligation imposed by section 251(b)(5) of the Act is traffic subject to "equal access and nondiscriminatory interconnection restrictions and obligations (including receipt of compensation) that apply… on the date immediately preceding the date of enactment of the Telecommunications Act of 1996 under any court order, consent decree, or regulation, order, or policy, until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission after such date of enactment."
  - The D.C. Circuit already has concluded that ISP-bound traffic *is not* subject to any pre-Act obligation, under section 251(g), that would exempt ISP-bound traffic from section 251(b)(5) reciprocal compensation.

- **Whether ISP-Bound Traffic Is Local or Treated as Local or is "Exchange Access" Is Not Dispositive.** Consistent with the Act, the Commission's rules do not limit or restrict reciprocal compensation to "local" telecommunications traffic or "telephone exchange service".
  - In the *ISP Remand Order*, the Commission removed from its rules qualifying language that would limit the scope of reciprocal compensation to "local" telecommunications traffic.
  - In so doing, the Commission correctly held that: "telecommunications subject to those provisions [sections 251(b)(5) and 251(d)(2) of the Act] are all such telecommunications not excluded by section 251(g)."
  - ISP-bound traffic, nevertheless, is local traffic and has been treated as local traffic, regardless of its jurisdictional nature.

- The Commission need not resolve the question of whether ISP-bound traffic is "telephone exchange service", "exchange access" or some invented third category of traffic, in order to affirm the applicability of Section 251(b)(5) to ISP-bound traffic. In any event, ISP-bound traffic does not meet the definition of "exchange access" and long has been treated as "telephone exchange service".
    - ISPs are not IXCs – they do not provide "telephone toll service".
    - In the 1996 *Non-Accounting Safeguards Order*, the Commission correctly determined that "ISPs do not use exchange access".
- The physical location of the ISP also is irrelevant to the issue of whether reciprocal compensation is due under section 251(b)(5) – no exception is made for ISP-bound calls terminated via FX/vNXX arrangements (regardless of whether employed by an ILEC or CLEC). Regardless of the physical location of an ISP's equipment or its mailing address, ISP-bound calls exchanged between LECs are not excepted from section 251(b)(5) reciprocal compensation.
    - To this day, ILECs routinely bill reciprocal compensation to CLECs for the termination of ISP-bound and FX (or FX-type) traffic.

- **For Compensation Purposes, the Functionality "Termination" Matters – Not the End or Ultimate Termination Point(s) of the Communication.** The delivery of an ISP-bound call involves the "transport" and "termination" functions defined in the Commission's rules. Specifically, the terminating LEC "transports" and "terminates" telecommunications traffic originated on the network of another LEC to the called party, which is the ISP. While the ultimate end-point(s) of the communication have been found to be relevant for determining jurisdiction, these points are not relevant for determining whether ISP-bound traffic falls under some invented exception to section 251(b)(5).
    - The *Bell Atlantic* court noted that calls to ISPs fit squarely within the definition of "termination" set forth in the *Local Competition Order* and section 51.701(d) of the Commission's rules: "the traffic is switched by the LEC, whose customer is the ISP and then delivered to the ISP, which is clearly the 'called party.'"
    - Even Verizon and BellSouth admit that their end users place calls to ISPs. *See* Verizon/BellSouth May 14, 2004 "White Paper" at 42 ("An end-user customer seeking to access the Internet initiates a communication by placing a call to an ISP").
    - The terminating LEC is entitled to reciprocal compensation for terminating the initial component of a communication that may subsequently travel on other carriers' networks to points beyond where that connection is completed. For the terminating LEC, its part of handling the call ends at the point that the call is terminated on its network and handed-off to the ISP. Looking at the call in this manner appropriately breaks the call down into relevant components without doing violence to the Commission's end-to-end

jurisdictional analysis (which overlooks intermediate points at which termination functionality is provided and instead focuses on where the communication ends).

- While the Verizon/BellSouth White Paper ignores the Commission's definition of "termination" and the *Bell Atlantic* decision with respect to it, the Commission may not follow their lead. The Verizon/BellSouth repackaging of arguments squarely rejected in *Bell Atlantic*, would, if adopted, surely be vacated again.
    - Contrary to Verizon and BellSouth's suggestion, neither section 251(b)(5) nor section 252(d)(2) use the word "terminates" or incorporate a requirement that the ultimate end-point of communication must be the same as the point of "termination" (as defined) in order to qualify for compensation. (And surely, these two wouldn't argue that the functionality provided at an intermediate point of termination is irrelevant for the purpose of collecting access charges.)

II. The Jurisdictional Nature of ISP-Bound Traffic Does Not Remove It from the Scope of Section 251(b)(5)

- Consistent with the *Bell Atlantic* decision the Commission must separately address: (1) the appropriate characterization of ISP-bound for purposes of the Commission's jurisdiction; and (2) the appropriate characterization of ISP-bound traffic for purposes of regulatory treatment under section 251(b)(5) of the Act. The *Bell Atlantic* decision made clear that the Commission's jurisdictional analysis of ISP-bound traffic, under the *ISP Declaratory Ruling*, did not resolve whether ISP-bound traffic is subject to reciprocal compensation under section 251(b)(5) of the Act.

- The *Bell Atlantic* court flatly rejected the Commission's end-to-end jurisdictional analysis as a basis for concluding that ISP-bound traffic is not subject to reciprocal compensation under section 251(b)(5) of the Act. The Commission did not provide a reasoned explanation, in the ISP *Remand Order* or otherwise, that would render the Commission's jurisdictional analysis relevant or controlling as to the regulatory treatment of ISP-bound traffic for purposes of reciprocal compensation under section 251(b)(5).

III. A Finding By the Commission That ISP-Bound Traffic Is Subject to Reciprocal Compensation Under Section 251(b)(5) Is Consistent With Commission and Judicial Precedent

- The Commission historically has treated ESPs, including ISPs, as non-carrier end users, exempt from the Commission's access charge regime. As such, ESPs, including ISPs, have purchased access to the PSTN under LECs' local exchange business services tariffs, and correspondingly, LECs have characterized expenses and

revenues associated with ISP-bound traffic as intrastate for separations purposes. Even following the Act, the Commission consistently has preserved its so-called "ESP exemption" as a lawful exercise of its authority to treat jurisdictionally interstate traffic as "local," and otherwise exempt from the Commission's access charge regime. Specifically, under the *Access Charge Reform Order*, the Commission reaffirmed that ESPs are end users for purposes related to the Commission's access charge regime. On appeal, the Eighth Circuit upheld the *Access Charge Reform Order* as a reasonable exercise of the Commission's discretion. Similarly, under the *ISP Declaratory Ruling*, the Commission expressly preserved its so-called "ESP exemption," and in so doing, acknowledged that jurisdictionally interstate traffic *may*, in certain circumstances, be treated as "local" traffic for the Commission's regulatory purposes.

- The *Bell Atlantic* court sharply criticized the Commission's apparent departure from its ESP exemption in its advocacy for the *ISP Declaratory Ruling*. Subsequently, the D.C. Circuit, relying on *Bell Atlantic*, flatly rejected the Commission's reasoning the *Advanced Service Remand Order* that ISP-bound traffic constitutes "exchange access traffic" within the meaning of the Act. Accordingly, the ESP exemption has been preserved since 1983.

IV. A Finding By the Commission That ISP-Bound Traffic Is Subject to Reciprocal Compensation Would Permit "Mutual and Reciprocal Recovery" of Carriers' Costs Under Section 252(d)(2)

- Verizon's claim that reciprocal compensation for ISP-bound traffic would preclude "mutual and reciprocal recovery" of carriers costs, as required by section 252(d)(2), is entirely without merit. To the contrary, reciprocal compensation would permit interconnecting carriers to recover the "additional" costs incurred for the same "transport" and "termination" functions performed by each carrier, as necessary to deliver ISP-bound calls to their customers.
  - The balance of traffic between interconnecting carriers is not relevant to the Commission's analysis under section 252(d)(2) as Verizon suggests. Indeed, if traffic flows between interconnecting carriers consistently remained in balance, reciprocal compensation would serve no practical purpose, as amounts exchanged would result in a wash.

- There is no merit to Verizon's claim that a bill-and-keep intercarrier compensation regime is appropriate where, as here, the telecommunications traffic exchanged between interconnecting carriers is out of balance. To the contrary, the Commission has concluded that a bill-and-keep regime is appropriate to minimize administrative burdens and transaction costs *only if* the interconnecting carriers' rates for traffic termination are symmetrical and traffic is roughly balanced, such that payments from one carrier to the other can be expected to be offset by payments in the opposite direction. The Commission concluded that: "carriers incur costs in terminating traffic that are not *de minimis*, and consequently, bill-and-keep arrangements that lack any

provisions for compensation do not provide for recovery of costs." Accordingly, the imbalance of traffic between carriers provides a compelling reason why reciprocal compensation *is* in fact necessary to provide for "mutual compensation and recovery of costs" – and why a bill-and-keep regime is not appropriate in the present context.

V. The Commission Has No Authority To Impose a Zero-Rate Intercarrier Compensation Rate or Equivalent Rate Structure Under Section 251(b)(5)

- The Act requires, and the Supreme Court in *AT&T* has affirmed, that rates and charges for transport and termination of telecommunications traffic, under section 252(d)(2), must be determined by the state commissions. Specifically, the Act delegates exclusively to the state commissions the authority to establish "terms and conditions that provide for mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier." 47 U.S.C. § 252(d)(2)(A)(i). Although the *AT&T* Court recognized that the "rate-establishing" delegation to the state commissions "does not logically preclude the Commission's issuance of rules to guide the state-commission judgments," the Court nonetheless made clear that the section 252(c)(2) places affirmative limitations on the Commission's authority. Accordingly, any effort by the Commission to establish reciprocal compensation rates in this proceeding, including a "zero-rate" or bill-and-keep rate structure mandating an effective zero rate for out-of-balance traffic exchanges, would violate the division of responsibilities/jurisdiction set forth in the Act.
    - The $0.0007 rate currently in place represents an unjustified fraction of what the ILECs receive for terminating local traffic, including FX, ISP-bound and CMRS traffic, and an even smaller faction of what the ILECs receive for access traffic. The Commission can begin to eliminate ILEC arbitrage opportunities – and their uneconomic consequences – by closing some of the gaps now: it should plainly state that all ISP-bound and vNXX/FX traffic are subject to section 251(b)(5) reciprocal compensation at rates set by the state commissions in compliance with section 252(d)(2).

VI. The Commission Must End Years of ILEC Arbitrage Made Possible by Its *ISP Remand Order*

- As a result of the *ISP Remand Order,* ILECs have been avoiding reciprocal compensation and have been paying artificially reduced rates – or nothing at all – to CLECs for the transport and termination of *ISP-bound traffic.* This Commission-provided discount off of TELRIC-compliant transport and termination rates creates pure regulatory arbitrage that results in a cost-savings windfall to ILECs that generally have been unwilling to provide competitive services to the ISPs that have switched to CLECs willing to meet their needs. Moreover, it leaves CLECs under- or entirely un-compensated for the transport and termination services they provide to ILECs and their customers.

- Compensation caps and new market restrictions enhance the ILEC arbitrage opportunity and unfairly discriminate among CLECs. These rules must be eliminated.
- The best way to address competing accusations of arbitrage is to require payment of a cost-based rate. Conveniently, section 251(b)(5) requires just such a result. Only the ILECs know whether they are net payors or payees of reciprocal compensation. If they seek to address an imbalance with respect to dial-up ISP bound traffic in particular, they can expand broadband offerings (which would replace such dial-up usage) and they can compete for ISP customers more effectively. So far, the ILECs have lost in this market sector – despite the Commission's attempt to cure the ILECs' failure to compete with the intercarrier compensation scheme remanded by the DC Circuit.